

HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

B-71 Cannon HOB ■ Washington, DC 20515 ■ 202-226-7200 ■ www.house.gov/budget_democrats

January 29, 2003

As Good as It Gets: New CBO Budget Outlook Shows Chronic Deficits Even Without New Policies

Dear Democratic Colleague,

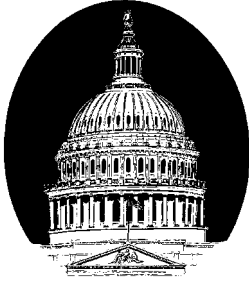
This morning, the Congressional Budget Office (CBO) reported that the \$5.6 trillion ten-year surplus projected two years ago has disappeared. Excluding the Social Security surplus, the budget now shows deficits for as far as the eye can see, assuming the 2001 tax cut is permanent. Spending for interest on the swelling public debt is now projected to be \$1.336 trillion higher than projected at the beginning of 2001.

It is important to remember that the new CBO budget outlook is a *baseline* projection that assumes current law remains unchanged. Thus, the new figures do not include the budgetary costs of war with Iraq, new tax cuts, or securing the homeland. As such, today's forecast shows the budget in a more favorable light than a projection that included the cost of the sizeable new initiatives the President is proposing.

Unfortunately, the House Budget Committee is not holding a hearing at which Members could inquire into the disappearance of the budget surplus. Thus, I hope you will find helpful the attached analysis by the House Budget Committee Democratic staff. If you have questions, please feel free to contact the Budget Committee Democrats at 6-7200 or consult our website at www.house.gov/budget_democrats/.

Sincerely,

John M. Spratt, Jr.
Ranking Member



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As Good as It Gets: New CBO Budget Outlook Shows Chronic Deficits Even Without New Policies

This morning, the Congressional Budget Office (CBO) reported that the unified budget will remain in deficit until 2007, even without enactment of any new initiatives. Excluding the Social Security surplus, however, the budget will remain in deficit indefinitely if the 2001 tax cut is permanent. The \$5.6 trillion ten-year unified surplus projected two years ago for 2002-2011 is gone. The fact that CBO assumes in this baseline projection no policy changes to current law — whether war with Iraq or more tax cuts — means that this projection understates the severity of the budget situation.

Republicans had insisted two years ago that predicted surpluses were so huge and so certain that they could accommodate large and growing tax cuts, a major defense buildup, new investments in education, adequate funding of other priorities — and still have enough left over to provide for unforeseen contingencies. They argued that a great fiscal danger facing the United States was the possibility that too much of the public debt would be paid off. Now, CBO foresees growing public debt rising by half a trillion to \$4.045 trillion in 2006 — provided no new actions are taken to widen the deficit.

The most salient features — one can hardly call them “highlights” — of CBO’s new budget projections are:

- ***CBO has revised its outlook for the unified budget for the worse by \$385 billion for 2003 through 2012, last year’s ten-year budget window.*** Most of this deterioration results from weaker tax revenues coming into the Treasury.
- ***CBO projects that publicly held debt will increase by \$505 billion between now and the end of 2006.*** Public debt will not dip below its current level of \$3.540 trillion until 2011. The re-emergence of chronic deficits means that Federal spending for interest on the public debt will be \$1.334 trillion higher for 2002 through 2011 than projected just two years ago.

- ***CBO's baseline projection shows a \$1.231 trillion deficit if one excludes the Social Security Trust Fund surplus.*** CBO projects a return to unified budget balance in 2007 but foresees unending annual deficits for the non-Social Security budget if the 2001 tax cut is extended. CBO believes that on-budget deficits will persist even after the economy resumes strong growth.
- ***CBO's budget outlook is a baseline projection that assumes that no actions that would widen the deficit will be taken.*** Thus, CBO's budget numbers, as dire as they are, represent the best one can expect, because additional tax cuts, war in Iraq, and securing the homeland will put heavier demands on the budget. For example, just making permanent the 2001 tax cut would worsen the budget outlook by \$785 billion.

The Most Dramatic Fiscal Reversal in U.S. History Threatens America's Future

The \$5.6 trillion unified surplus for 2002-11 predicted by the Bush Administration when it took office has disappeared. Together, the actual deficits for 2002 and 2003 plus CBO's new projections now show a minuscule ten-year unified surplus of \$20 billion for 2002 through 2011. The projected ten-year unified budget surplus for 2004 through 2013, at \$1.336 trillion, looks better than this trivial \$20 billion. That is because it does not include large annual deficits this year and last, but it does include years after the first Bush tax cut ostensibly expires.

Social Security Surplus Squandered. The reversal of the budget excluding the Social Security Trust Fund surplus over the last two years has been equally severe — but more worrisome because the Baby Boom will begin retiring in five short years. When President Bush took office, he projected an on-budget, or non-Social Security, surplus of \$3.142 trillion. At that time and even as recently as 17 months ago, the Administration claimed that preserving “surpluses at least the size of the Social Security surplus” was a “threshold condition of public finance” commanding bi-partisan support.¹

Now, the non-Social Security budget shows a \$2.221 trillion deficit for 2002 through 2011. The Social Security Trust Fund surplus is spent in every year for the foreseeable future, assuming the 2001 tax cut is permanent. Two years ago, both defenders of the current Social Security system and advocates for privatization hoped that the large and growing non-Social Security surpluses could be used to prepare for the fiscal challenges of the Baby Boom's retirement. Now, the resources that might have helped to meet the coming demographic tidal wave are gone.

Administration Claims That Budget Deficits Do Not Matter. The Administration has begun trying to argue that even unified budget deficits — which include the offsetting effects of the Social Security Trust Fund surplus — do not hurt the economy. Whereas the Administration previously claimed that large and sustained unified surpluses were a threshold condition of responsible budgeting, it now says that hundreds of billions of dollars of additional public debt

¹*Mid-Session Review of the Budget of the United States Government*, August 22, 2001, page 2.

will have a trivial effect on the economy's long-term health. This contradicts the professional consensus among economists and public statements by Treasury Secretary-Designate John Snow. It also contradicts the teachings of a 2002 textbook² authored by the President's chief economist, Glenn Hubbard — the same person now arguing that chronic deficits will not affect credit markets.

CBO's Budget Outlook Is a *Baseline* Forecast

It is very important to recognize that CBO's most recent budget outlook assumes no changes to existing policies. For instance, CBO's baseline forecast assumes that the tax code is not changed and that the large 2001 tax cut expires in 2010 as the law currently stipulates. Thus, CBO's budget projection appears to make a sharp recovery in 2011, when the tax cut ostensibly expires. Largely as a consequence of this assumption, 93 percent of CBO's projected unified surplus occurs in 2011 through 2013. If the 2001 tax cut is made permanent, that by itself would worsen the budget outlook by \$785 billion.

Similarly, CBO assumes that appropriations funding grows only enough to offset inflation. It makes no provision for the invasion and occupation of Iraq, for increased homeland security needs, for increased investments in education, or for any number of other priorities that might require budgetary resources. For instance, merely granting the President's defense request from last year would, by itself, worsen the ten-year deficit outlook by about \$200 billion.

By contrast, the Bush budget to be released on Monday, February 3, will combine OMB's somewhat rosier prediction of the budget baseline with Administration estimates of the costs of the President's proposals for new tax cuts and spending. Therefore, comparisons between CBO's budget outlook and the one the Administration will release on Monday should be done carefully. Last year, White House officials mistakenly claimed that OMB and CBO budget projections were similar based on a comparison of CBO's *baseline* with the Administration's *post-policy* projection.

The degree to which the Administration is more optimistic than CBO should be measured by the difference between CBO's baseline and OMB's baseline. Comparing CBO's baseline with the President's baseline avoids the "apples-to-oranges" comparison underlying last year's mistake by the Administration. CBO will issue its estimate of the President's budget — delineating both baseline differences and differing estimates of what the President policies cost — in late February or early March.

New CBO Projections Show Yet Another More Pessimistic Revision of the Budget Outlook

Budget figures for 2003 through 2012 have deteriorated by another \$385 billion since

²*Money, the Financial System, and the Economy*, Addison-Wesley Publishing Company, fourth edition, 2002, page 661.

CBO released its budget update last summer. This downward revision comes on top of successively more pessimistic assessments since President Bush was inaugurated. As a result, budget figures for 2002 through 2011 — the ten-year budget window when the Administration took office — have deteriorated by a shocking \$ 5.6 trillion in less than two years.

CBO's more pessimistic assessment of the budget this morning may not be the last of the adverse budget revisions, because there is a delay between the sinking stock market and the revenues that respond to it. Even before the stock market's renewed swoon, analysts expected that revenues related to capital gains, stock options, and bonuses would remain weak for some time. Some investors will continue to take capital losses for at least a few years, even if the market now begins to recover. The current level of the S&P 500 — more than 25 percent below its level a year ago and more than 35 percent below its level when President Bush took office — is so low that it may be some years before capital gains realizations recover.

Public Debt and Interest on It Will Soar

Republicans' biggest fiscal concern two years ago was their fear that we might pay off *too much* public debt. That problem has been solved and replaced by worse problems: growing public debt and soaring federal spending for interest on that debt.

CBO currently projects that publicly held debt will grow from its current level of \$ 3.540 trillion to \$4.045 trillion at the end of 2006, before beginning a gradual decline. The peak debt level that CBO predicts — assuming no new policies that widen the deficit — would be the highest on record.

Interest must be paid on the public debt, and any budgetary resources devoted to this purpose cannot be used for other national priorities. The re-emergence of chronic deficits means that Federal spending for interest on the public debt will be \$1.334 trillion higher for 2002 through 2011 than projected just two years ago.

This immense increase in the resources needed merely to keep the government from defaulting illustrates the budget's shift from a "virtuous circle" of debt reduction to the "vicious circle" of growing debt. When surpluses were reducing public debt in the late 1990s, declining federal spending on interest helped to produce still larger surpluses, in a self-reinforcing manner. Now that deficits are again pushing up public debt, higher spending for interest on that additional debt will worsen future deficits and add still more debt.

Surplus Declines Over \$5 Trillion During Bush Administration

Unified Budget Surplus, CBO Baseline
Trillions of Dollars

	2002-2011	2004-2013
May 2001	5.629	N.A.
January 2003	0.020	1.336

Budget Picture Declines Drastically Under Republican Leadership

On-Budget Surplus, CBO Baseline
Trillions of Dollars

	2002-2011	2004-2013
May 2001	3.142	N.A.
January 2003	-2.221	-1.231

Bush Policies Dig Deficit Hole Even Deeper

Unified Budget Surplus, Trillions of Dollars

	2002-2011	2004-2013
May 2001 Baseline	5.629	N.A.
Jan 2003 Baseline plus President's Policies	-1.519	-1.104

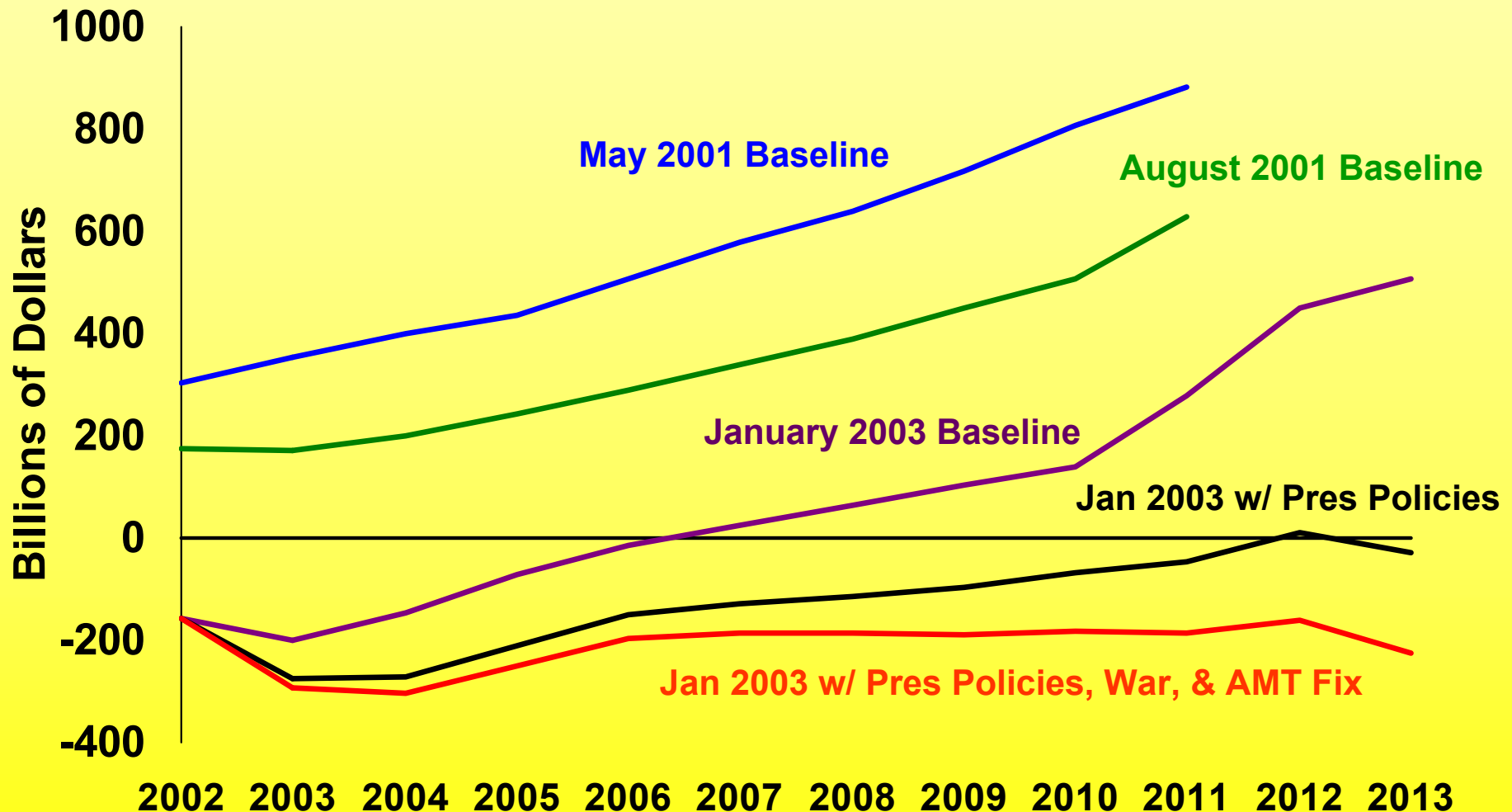
Bush Policies Dig Deficit Hole Even Deeper

On-Budget Surplus, Trillions of Dollars

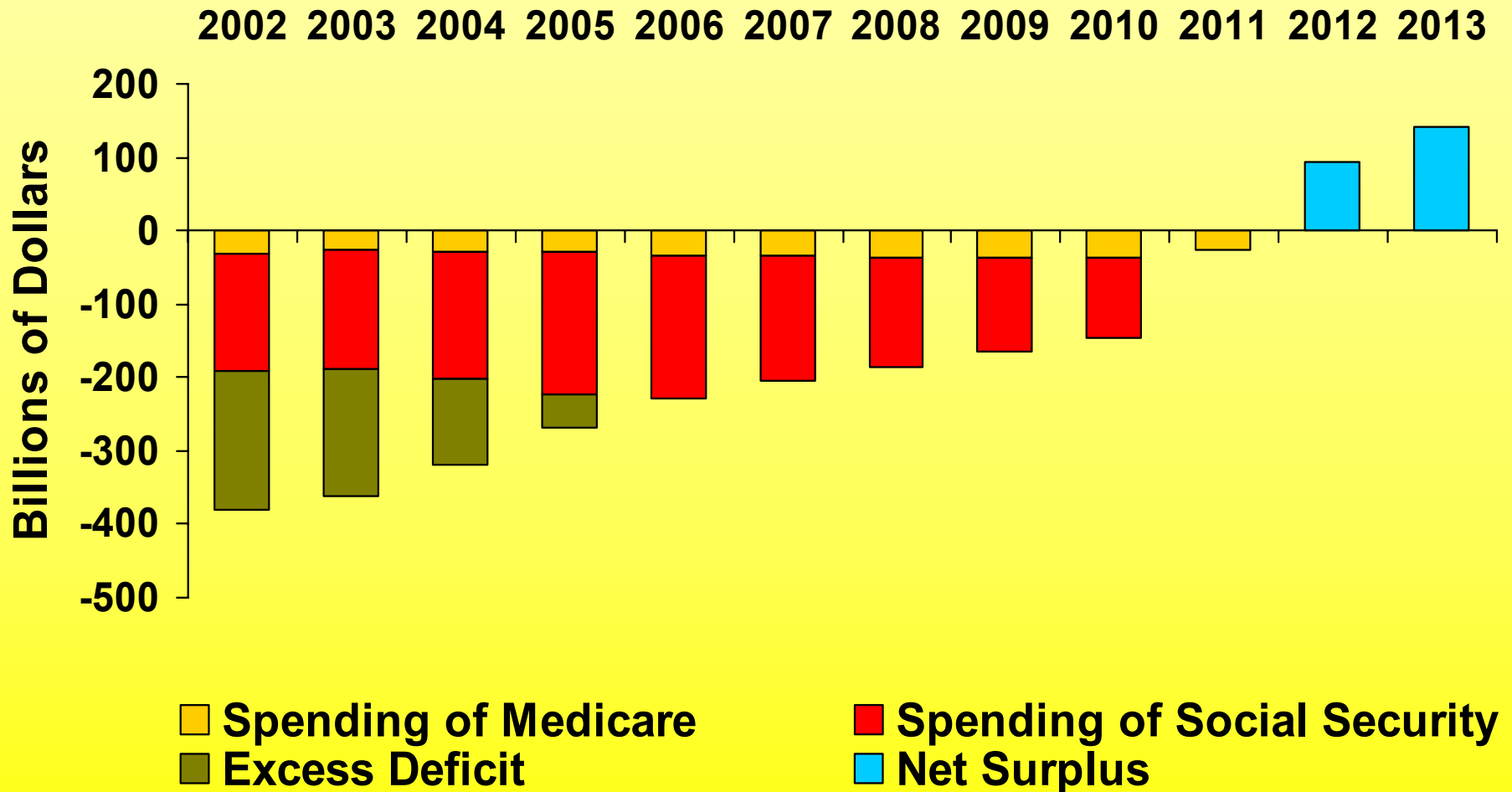
	2002-2011	2004-2013
May 2001 Baseline	3.142	N.A.
Jan 2003 Baseline plus President's Policies	-3.761	-3.672

What Happened to the Surplus?

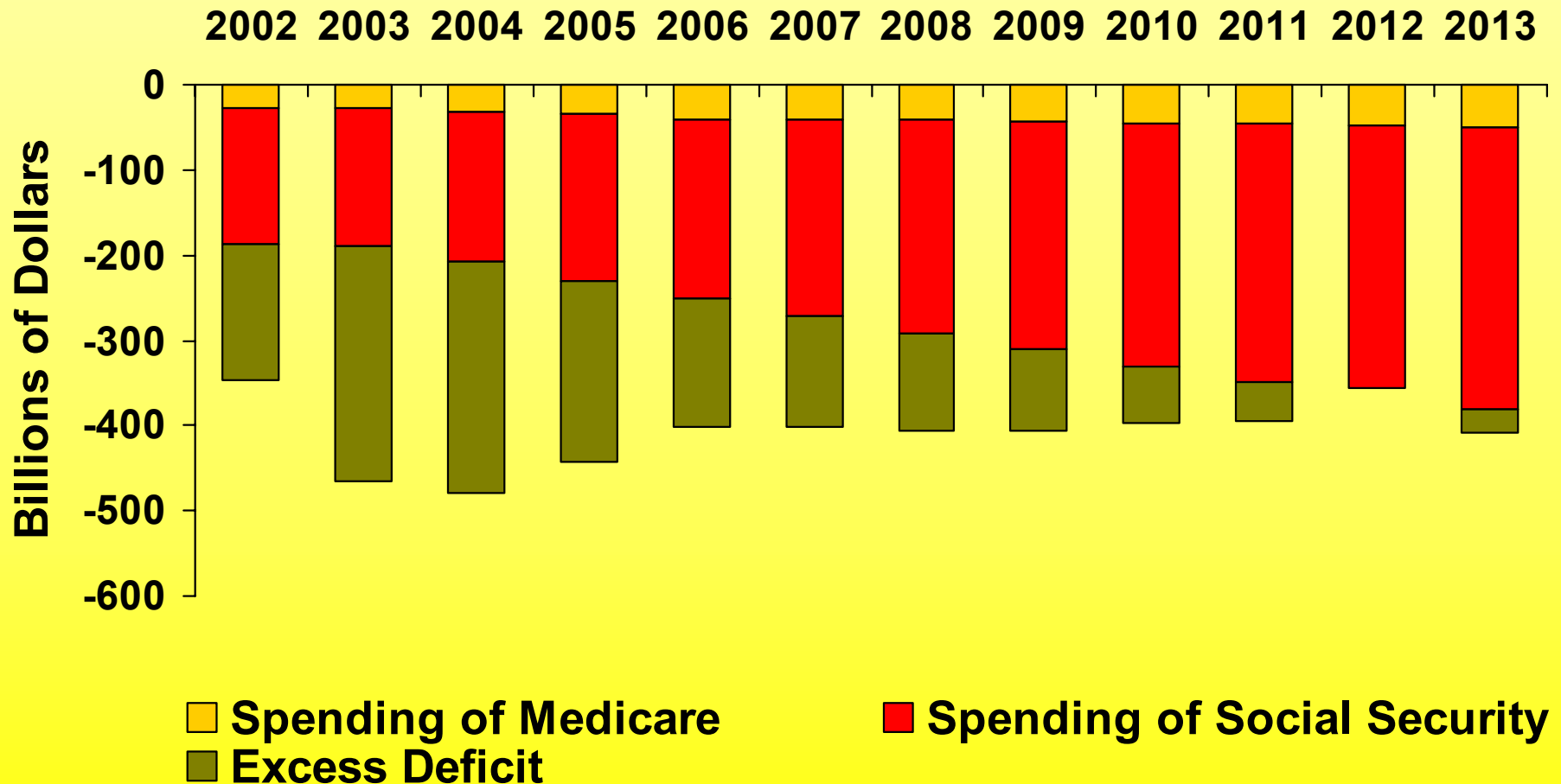
Unified Surplus or Deficit



Enacted Bush Policies Wipe Out Surplus



Bush's New Policies Spend Social Security and Medicare



CBO BUDGET OUTLOOK

29-Jan-03

MAY 2001 BASELINE	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2004-2013</u>	<u>2002-2011</u>
Unified Surplus	304	353	400	437	508	578	641	718	806	883	N.A.	N.A.	N.A.	5,629
On-Budget Surplus	132	166	197	215	270	322	366	425	495	553	N.A.	N.A.	N.A.	3,142
Off-Budget Surplus	172	187	202	221	238	256	275	293	311	330	N.A.	N.A.	N.A.	2,487
JANUARY 2003 BASELINE	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2004-2013</u>	<u>2002-2011</u>
Unified Surplus	-158	-199	-145	-73	-16	26	65	103	140	277	451	508	1,336	20
On-Budget Surplus	-317	-361	-319	-268	-228	-205	-185	-165	-145	-26	134	177	-1,231	-2,221
Off-Budget Surplus	160	162	174	195	212	231	250	268	286	303	317	330	2,568	2,241
PRESIDENT'S JULY BUDGET PROPOSALS -- INCLUDING 2001 TAX CUTS MADE PERMANENT								<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2004-2013</u>	<u>2002-2011</u>
Tax Cuts	0	0	-6	-11	-18	-24	-28	-27	-27	-133	-238	-250	-763	-274
Spending Increases	0	0	-9	-16	-19	-36	-48	-63	-71	-82	-83	-118	-545	-343
FY 2004 BUDGET	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2004-2013</u>	<u>2002-2011</u>
January 2003 Stimulus	0	-73	-107	-98	-63	-55	-53	-52	-46	-39	-43	-46	-601	-585
Possible Bush Rx (addtl.)	0	-2	-3	-3	-16	-19	-21	-22	-24	-24	-26	-62	-219	-134
Total	0	-75	-124	-128	-116	-133	-150	-165	-168	-278	-390	-476	-2,128	-1,337
Debt Service	0	-1	-4	-11	-17	-23	-28	-34	-40	-45	-51	-59	-312	-202
OUTLOOK WITH PRESIDENT'S POLICIES			<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2004-2013</u>	<u>2002-2011</u>
Remaining Unified Surplus	-158	-275	-273	-212	-149	-130	-113	-96	-67	-46	10	-28	-1,104	-1,519
On-Budget Surplus	-317	-437	-448	-408	-361	-361	-363	-364	-353	-349	-308	-358	-3,672	-3,761
Off-Budget Surplus	160	162	174	195	212	231	250	268	286	303	317	330	2,568	2,241
IRAQ WAR	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2004-2013</u>	<u>2002-2011</u>
Direct Cost	0	-18	-24	-20	-12	-3	-1	0	0	0	0	0	-60	-77
Debt Service	0	0	-1	-2	-4	-4	-5	-5	-5	-6	-6	-6	-43	-31
REMAINING AGENDA	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2004-2013</u>	<u>2002-2011</u>
AMT Repair (Extender)	0	0	0	-4	-11	-16	-20	-24	-27	-30	-33	-36	-200	-131
AMT Repair (To Prior Law)	0	0	0	0	-1	-6	-10	-15	-21	-24	-29	-34	-142	-79
AMT Repair (Reform)	0	-1	-4	-8	-15	-19	-25	-34	-42	-52	-64	-76	-339	-200
Total Cost	0	-19	-28	-34	-42	-48	-61	-78	-95	-112	-132	-152	-783	-518
Debt Service	0	0	-1	-3	-5	-8	-12	-16	-22	-29	-37	-46	-180	-96
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2004-2013</u>	<u>2002-2011</u>
Remaining Unified Surplus	-158	-294	-303	-250	-197	-186	-185	-190	-183	-187	-159	-226	-2,067	-2,134
On-Budget Surplus	-317	-456	-477	-445	-409	-417	-436	-458	-469	-490	-476	-557	-4,635	-4,375
Off-Budget Surplus	160	162	174	195	212	231	250	268	286	303	317	330	2,568	2,241